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CORPORATIONS-SECURITIES ACT OF 1933--SALE OF SHARES TO EMPLOYEES AS NOT INVOLVING A PUBLIC OFFERING

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CORPORATIONS—SECURITIES ACT OF 1933—SALE OF SHARES TO EMPLOYEES AS NOT INVOLVING A PUBLIC OFFERING—As it had done in the nine preceding years defendant corporation sought to win the loyalty of its key employees by offering for their direct purchase some 10,000 shares of its common stock at a price comparing favorably with that in the market. Plaintiff commission sought to enjoin the sale in the federal district court under §77(e) of the Securities Act of 1933[1] which prohibits sales by mail or interstate commerce of securities not registered with plaintiff. The defense was that §77(d)(1) exempted the sale from registration as one "not involving a public offering." *Held,* judgment for the defendant. This is not an offering of shares to the public but merely a sensible way of improving the employer-employee relationship. *Securities & Exchange Commission v. Ralston Purina Co.,* (D.C. Mo. 1952) 102 F. Supp. 964.

Congress may have intended the number of acceptors to be decisive in determining whether a public offering has been made within the meaning of the exemption clause in §77(d)(1).[2] However, this would mean that an offer addressed to all the world is not public if its acceptance is limited to the one man who is first with his money. It would also mean that in determining when a registration statement is required, the courts are to ignore the very persons for whose benefit the requirement is designed, that is, the persons to whom an offer to sell the shares is made and who can use the statement's information to decide whether to accept.[3] In the few cases thus far decided on the point, the courts make it clear that an offering is public or not depending on the particular facts of each case,[4] with special emphasis on the number of persons to whom

[1] 15 U.S.C. (1946) §77a.

[2] An issuer may "make a specific or an isolated sale of its securities to a particular person, but . . . if a sale . . . should be made generally to the public . . . that transaction shall come within the purview of the act." H.Rep. No. 85, 73d Cong., 1st sess. 16 (1933). Cf. H.Rep. No. 152, 73d Cong., 1st sess. 25 (1933): "Sales of stock to stockholders become subject to the act unless the stockholders are so small in number that the sale to them does not become a public offering."

[3] The registration statement must contain, inter alia, information concerning profit and loss, capitalization and funded debt, basis for computing asking price, and purposes to which proceeds will be put. 15 U.S.C. (1946) §77(aa), Schedule A.

[4] S.E.C. v. Sunbeam Gold Mines Co., (9th Cir. 1938) 95 F. (2d) 699.

the original offer is made,[5] their knowledge of the value of the shares, and the manner in which the offering is made. As to the first factor, there is little authority on the crucial issue of how many original offerees are needed to make an offering public. The decided cases involve either so many or so few offerees that the issue is not fairly raised,[6] and in the principal case it was not even considered. It is suggested that the courts adopt as a working hypothesis the commission's contention in the principal case that an offering is public when made to more than 100 persons, or, if this test seems too rigid, adopt the standard of "substantial number of offerees" suggested in an early commission release.[7] At any rate, in the principal case the 500 offerees numbering about seven per cent of the total working force are a rather large number for a private offering. It is submitted that on principle the courts should also consider the number of second-hand offerees created by turnover of the original issue, since they too need the information of a registration statement. In the principal case this number would be small since, although 5,000 shares were likely to be accepted and at a price low enough to permit resale, the employees who accepted generally resold only on leaving defendant's employ. The second factor to be considered is whether the offeree has firsthand knowledge of what he is buying.[8] Indeed, the very word "public" suggests a distinction between the outsider, who buys on the basis of secondary information, and the insider, who can rely on close contact with the facts which determine the value of the shares. It is suggested that this test be redefined in terms of the informational purpose of the registration statement. Thus a public offering ought to be found and a registration statement required whenever the offeree is so deficient in firsthand knowledge that he needs the information which the statement is designed to disclose. Division of labor in a large corporation would seem to make it improbable that very many of the 500 key employees in the principal case knew firsthand the value of their corporation's shares. The third factor to be considered is the manner in which the offering is made. Newspaper advertisements and form

[5] Public offerings were found in Corporation Trust Co. v. Logan, (D.C. Del. 1943) 52 F. Supp. 999 (open-end trust agreement running to 800,000 shares held by 3,500 persons); and in Merger Mines Corp. v. Grismer, (9th Cir. 1943) 137 F. (2d) 335 (readjustment of capital account involving 1100 shareholders).

[6] The closest case was Merger Mines Corp. v. Grismer, supra note 5.

[7] Release No. 97, Pt. 6, Dec. 28, 1933, quoted in 1 CCH FED. SEC. LAW SERV. ¶2266.41, based on H.Rep. No. 85, 73d Cong., 1st sess. 16 (1933), supra note 1. This release was modified in Release No. 285, Jan. 24, 1935, quoted in 1 CCH FED. SEC. LAW SERV. ¶2266.17, which set out as criteria the number of offerees and their relationship to each other and to the issuer, number of units offered, size of offering, and manner of offering.

[8] Campbell v. Degenther, (D.C. Pa. 1951) 4 CCH FED. SEC. LAW SERV. ¶90,508 (offer to former partner); and S.E.C. v. Federal Compress & Warehouse Co., (D.C. Tenn. 1936) 1 CCH FED. SEC. LAW SERV. ¶2266.52 (offer to shareholders who lived close to corporation's head office and knew its officers and general state of affairs). Cf. H.Rep. No. 1838, 73d Cong., 2d sess. 41 (1934), stating that "the parties in employees stock investment plans may be in as great need of the protection afforded by the availability of information concerning the issuer for whom they work as are most other members of the public."

letters tend to indicate a public offering,[9] but transmission by word of mouth does not. In the principal case the employees to be offered shares were contacted personally by their department managers, so that, on this ground at least, the offering appears private. It is inevitable that courts will tend to find grounds for exemption from registration when the offering is clearly beneficial to all concerned and registration seems a needless form.[10] Thus the principal case held no public offering on finding that the offering was a mutually advantageous way to better the employer-employee relationship. Although the result in the case cannot be severely criticized, it would seem that the court's approach was erroneous in ignoring the standards prescribed by the statute and the decided cases and in basing its decision purely on grounds of policy.

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[9] People v. Ruthven, 160 Misc. 112, 288 N.Y.S. 631 (1936), decided under New York General Business Law.

[10] Cf. Siebenthaler v. Aircraft Accessories Corp., (D.C. Mo. 1940) 1 CCH FED. SEC. LAW SERV. ¶2266.15, which exempted a sale of shares for needed property.